



1942

Economic Conditions Governmental Finance United States Securities

New York, December, 1942

General Business Conditions

THE occupation of French North Africa by American and British troops under American command, the rout of Rommel's forces in Libya and of the Japanese fleet in the Solomons, and the assumption of the offensive by the Russian armies, have made November a momentous and immensely heartening month in the military situation. For several months the offensive of the Axis forces had been brought to a standstill, except for minor German progress in the Caucasus, and not since August had the enemy won any important victory. The next question was whether the United Nations could seize the initiative, and the North African occupation and the Libyan and Russian advances answered this in resounding terms.

With war production in this country mounting, and the coming months sure to bring a tremendous outpouring of equipment and trained men to use it, it is not too much to hope that the initiative will be held and the offensive widened. If this proves true, November may mark the turning point of the war. The armament output of the United Nations has passed that of the Axis powers, and it is still well below its peak. The morale of the United Nations is lifted, that of the Axis depressed; and in the Axis-occupied countries new stirrings of hope and opposition to their conquerors are aroused. The people of the United Nations everywhere feel a new stimulus to extra effort. Evidence of strengthening confidence, which reflects experienced financial opinion, has appeared in the securities markets, where prices of bonds of countries occupied or threatened by the Axis have risen sharply during the month. Shares of "peace" companies also have shown improvement, contrasting with relative weakness in heavy industry companies which will have the most difficult adjustments to make at the end of the war.

Fortunately there seems little likelihood that encouragement will go to the extreme, and turn into overconfidence. Nothing in the situation justifies expectation of victory without the "grim and probably long ordeals" of which Mr.

Churchill spoke November 29th. Both Government and people know there can be no relaxation in the all-out effort. On the contrary, the difficulties involved in carrying the offensive over the globe, in bringing vastly more men and equipment together in the right place at the right time, are even more stupendous than when the strategy is defensive. Greater demands must be made upon the industries, and therefore upon everyone. Business executives naturally and properly are concerned with estimating, from the course of events, the probable length of the war, with a view to preparing for the readjustments to come; but business policies are in the grip of the war to an ever-increasing extent, and not subject to major change until victory is actually at hand.

Pattern of the All-Out War Effort

Officials of the war agencies have made a number of public statements during the month, repeating and adding emphasis to previous declarations that regulation and restriction of consumer goods production and distribution will become increasingly tighter. These statements are to pave the way for further announcements of rationing, simplification of consumers' goods, curtailment of distributors' services, concentration of production in fewer plants, standardization of models and perhaps other measures. Mr. Byrnes, the Director of Economic Stabilization, asked the War Production Board to undertake a vigorous program of simplification and standardization. For sometime the official thinking has been along this line.

These statements again help to make clear the pattern that the economic organization will take, as adjustments to the all-out war effort are completed. Simplification, to reduce the number of types of goods and standardize design, saves labor in production and distribution and economizes on materials. It is appropriate for the nation at war, although it would be impracticable and undesirable in peacetime, when the productive organization exists for the purpose of supplying not what some overhead

BUY A WAR BOND A MONTH FOR VICTORY

authority thinks consumers should have, but what they themselves prefer to have. A considerable number of simplification and standardization practices are already in effect, extending from the regulations designed to save cloth in men's and women's clothing, which were established early in the year, to the recent limitation on the length of men's shirts and the size of umbrellas. Along with these orders go limitations on quantities produced. The extension of rationing is the necessary accompaniment of price control measures in cases where the commodity supply is falling below requirements, either because lack of shipping limits imports or because lend-lease needs and expanding domestic buying power keep demand ahead of production.

Moreover, limitations on consumer goods production may be enforced even in industries where the supply of materials and plant facilities are adequate, in order to release labor for war work. An official of the W.P.B. has told the fur manufacturing industry that it may be asked to suspend operations and make its workers available for war plants. This policy has already been applied in the case of the gold mining companies, and evidently is to be extended.

Rise in War Spending and Production

Consideration of measures such as the foregoing is in itself evidence that the going becomes harder as the volume of production comes closer to the limits of materials and manpower. The country has had a phenomenal rise in war expenditures and war production. War expenditures have jumped from \$153 millions in June, 1940, to well over \$6 billions during November. Industrial production has increased from 122 in June, 1940, according to the Federal Reserve Board's index (1935-39=100) to 188 in October; and all the increase, and more, in the aggregate, has been in production of goods for war. The Board states that more than 80 per cent of durable goods production, and well over half of total production, is for war.

These gains are stupendous, irrespective of opinions that they should have been even greater. Now that they have been made, it is to be expected that further progress, pressing harder against the ultimate limit of production, will be more difficult and obtainable only at the cost of expanded governmental control. The shift to the offensive itself increases the pressure on civilian supplies. As one example, the need to supply the requirements of the North African forces with petroleum products is a cause of the increasing tightness of the oil supply in the East, which has caused reduction in rations. The North African people will need food, as well as some manufactured goods formerly supplied from France, and it will be the policy of this country to supply them.

Doubtless the spread of the offensive in other areas will similarly increase the rush call on America's supplies.

In the production program itself shifts are being made. In the early stages of the production effort it seemed that there would hardly ever be enough of anything, but that period is passing. Now there are in sight enough of some things, and not enough of others. New experience and changing needs, following the turn to the offensive, suggest revisions in the program. Recent business reports include more instances of revision of armament contracts and suspension of projected construction than heretofore. Mr. C. E. Wilson, president of the General Motors Corporation, recently stated that the rate of increase in deliveries of his company would be slowed down by the shift of emphasis from tanks, trucks and guns to ships and airplanes.

Changes of this character signify that the production program is reaching maturity, and there is other evidence. Shipments of machine tools for the first time are exceeding new orders; and although the backlog is estimated still at more than nine months' capacity it seems unlikely to grow further. Contract revisions cause changeovers and temporary dislocations in production, and for the time being reduce the contribution to the war effort of the companies affected.

These, however, are incidental to the main trend. The supply of materials and manpower will permit further increases in production before the limit is reached, and a further rise of something like 15 to 20 per cent in aggregate industrial output should be possible before the peak is reached. The increase in the output of war goods should be much greater, due to further diversion of manpower, materials and plant facilities from civilian needs.

The promise latent in the capacity of the country's huge industrial machine is now gradually being realized in production of the machinery of war, excellent in quality and massive and growing in quantity.

The Victory Loan

On November 30, with the opening of the new \$9 billion Victory Loan campaign, the Treasury began its most important borrowing operation of the war. Reflecting the rising war costs and inauguration of a new plan of bi-monthly, rather than monthly, financing, the program calls for the biggest selling job since the Fourth Liberty Loan when 23 million investors bought approximately \$7 billions worth of securities, hitherto the largest single piece of government financing on record.

To insure the success of this gigantic undertaking the Treasury has organized a nationwide army of volunteer workers operating under the Victory Fund Committees in the

different Federal Reserve districts, and has provided them with a variety of securities designed to fit the needs of every type and class of investor. In addition to War Savings Bonds (Series E) and stamps, U. S. Savings Bonds (Series F and G), and Tax Savings Notes, there will be new issues of 1-year $\frac{7}{8}$ per cent certificates, $5\frac{1}{2}$ -year $1\frac{3}{4}$ per cent bonds, and 26-year $2\frac{1}{2}$ per cent bonds (callable in 21 years). Also, of course, there will be continuing issues of weekly discount bills. With so great an assortment of offerings of all classes, denominations and maturities to choose from, an opportunity is provided for every man, woman and child, and for every business concern and institution, to make some contribution to the war effort.

In still other ways the Treasury has endeavored to meet market requirements and preferences. The announcement of the terms of the offering a week in advance of opening the books, and the decision to hold the books open for public subscription, not merely 24 or 48 hours, as has been the custom heretofore, but several weeks, are both salutary changes when broad distribution is wanted. While the long-term $2\frac{1}{2}$ s have a slightly longer maturity than the $2\frac{1}{2}$ s brought out earlier this year, the investor is given a choice as between a coupon and registered bond. In the earlier issues only the registered form was available.

Recognizing the urgent need of raising as much money as possible outside the commercial banking system, the Treasury is making a special effort to encourage non-banking subscribers and to see that they get all they want. Thus, for all subscribers other than commercial banks, books on the three new issues were opened November 30 and will be held open several weeks, with all subscriptions to be allotted in full. Commercial banks, on the other hand, will be limited to an aggregate of \$2 billions or thereabouts of the short bonds and a like amount of certificates, with books on the bonds opening November 30 and closing December 2 and those on the certificates opening December 16 and closing December 18. As in the case of earlier issues this year, commercial banks are barred from holding the long-term $2\frac{1}{2}$ s until after a period of 10 years.

At the same time that the Treasury is conducting its drive on the new issues, it is not overlooking the possibilities for reaching current income and savings through tax notes and war savings bonds. Victory Fund Committees have been asked to promote purchases by corporate and other taxpayers of series A and C tax notes and Series F and G savings bonds, while the War Savings Staff will intensify its drive on the Series E savings bonds, with especial attention to extending the payroll deduction plan. The Treasury hopes to raise the present figure of 23 million workers now investing an average of 8 per cent of their pay

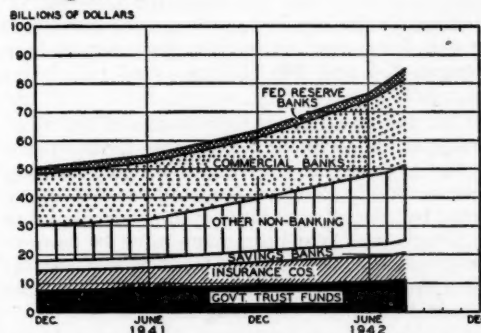
in savings bonds to a figure of at least 30 million workers setting aside an average of at least 10 per cent of their earnings every pay day.

The Major Task

All this represents a tremendous task and major test, in which the organization that has been set up to handle the financing is not on trial alone. The banker, by virtue of his position in the community, has a special responsibility for taking off his coat and getting down to work to make the financing a success. And finally it is a test of the sense of obligation of the American people and of the willingness of millions of individual men and women at home to make some contribution and sacrifice to the cause being upheld so valiantly on the fighting fronts.

As has been pointed out again and again, success in government financing is not merely a question of getting each Treasury issue oversubscribed. The important question is how the money is raised—whether in an inflationary manner through the banks, or in a non-inflationary manner out of the current income and savings of the public.

The following diagram showing the distribution of the public debt by different types of holders by months from December 1940 through August of this year indicates where the funds borrowed by the Treasury have been coming from.



Ownership of Government Obligations (Direct and Guaranteed). Latest Figures as of August 31, 1942

As will be seen from the diagram, commercial banks at the end of August held \$30 billions, or 35 per cent, of the total debt. All but a small portion of the balance (owned by the Federal Reserve) represented holdings of the social security and other government trust funds, insurance companies, mutual savings banks, and other non-commercial bank investors whose purchases are out of savings and involve no increase in bank deposits.

Of the Treasury net borrowing over the period, the bulk has come from the commercial banks and the miscellaneous investor group classified as "Other non-banking," where the in-

crease reflects chiefly expanded sales of war savings bonds to individuals and of tax notes, mainly to corporations. Absorption of debt by the insurance companies, mutual savings banks and government trust funds has also increased, but accounts for a much smaller part of the total.

In the search for new sources of funds for Treasury borrowing, the only areas capable of further widespread exploitation are the commercial banks and the idle funds of individuals and corporations. Large as are the resources of the government trust funds, the insurance companies and savings banks, when it comes to supplying the billions and billions of new money needed they can do only a relatively small part of the job.

This poses the problem in a nutshell — either we do the financing the easy and inflationary way of selling huge quantities of securities to the banks, or we do it the harder but non-inflationary way of expanding the sale of securities that will be paid for out of current income and savings. How formidable is the task may be seen by comparing the deficit for the current fiscal year ending June 30 next, now estimated at \$63 billions, with the trend of banking and non-banking absorption of federal securities indicated in the diagram. It will be found that even with savings bond sales estimated at \$12 billions a year, or \$1 billion a month, and liberal allowances for increases in other non-banking absorption, the indicated commercial banking (including Federal Reserve) purchases for this fiscal year alone foot up to somewhere between \$35 and \$40 billions. And this is far too much.

That the Treasury is fully aware of the magnitude of the problem is indicated by the plans made for the December financing emphasizing general public distribution, and by the statement by Secretary Morgenthau announcing the program: "War borrowing must be done to the greatest possible extent out of current income and savings of the people. This is the soundest means of financing the war deficit."

The Role of the Commercial Banks

Actually, even with the most energetic efforts to sell securities outside the commercial banking system, there will still be billions that the banks will have to take. In the December financing, for example, the portion allotted to the banks amounts, as already stated, to \$2 billions of the short bonds and \$2 billions of the certificates.

In order for the banks to play their part, two conditions are essential, (1) that the banks be supplied with the reserves needed to finance such purchases, and (2) that the banks be prepared to put such reserves fully to work.

The first condition is a responsibility, primarily, of the Federal Reserve Banks, and it

may be assumed that they will continue the policy pursued heretofore of keeping member banks supplied with all needed funds. This they can do, either by lowering the member bank legal reserve requirements against deposits, or by the purchase of government securities in the open market.

The second condition is a responsibility of the commercial banks, and involves a change in ideas and practices regarding the holding of excess reserves. During the period when bank reserves were rising rapidly and when demands for bank credit were limited, banks became accustomed to carrying large amounts of excess reserves. Now, however, an altogether different situation has arisen. With the heavy demands upon the banking system for financing the war, banks are no longer justified in carrying substantial amounts of funds in idle excess reserves. This is particularly true in view of the measures taken by the authorities to assure a plentiful supply of reserves and to enable individual banks to effect adjustments of reserve position promptly and easily. Such measures include not only the lowering of reserve requirements and the Reserve Bank purchases of government securities already cited, but also the standing offer of the Reserve Banks to buy Treasury bills at $\frac{3}{8}$ per cent with right of repurchase by the seller, and the establishment of a preferential discount rate at $\frac{1}{2}$ per cent for advances to member banks secured by government securities maturing or callable within a year.

In recognition of these factors, President Sproul of the New York Federal Reserve Bank, in a letter to member banks of the district, urged that "banks should now abandon the practice of holding large amounts of excess reserves, with the knowledge that by investing their funds more fully through purchases of Treasury securities, they will be assisting in the war effort without sacrificing their ability to meet any demands for cash which may be made upon them."

Still another question that has arisen in connection with the role of banks in the war financing has to do with the so-called "capital ratio" or traditional rule of thumb measure of 1 to 10 as the proper ratio of capital to deposits that banks ought to maintain. With the tremendous expansion of deposits certain to result from bank purchases of government securities, maintenance of this ratio is now obviously out of the question. In order, therefore, to clarify the position of the supervisory authorities and to encourage banks which might otherwise be deterred from subscribing fully to new government loans, the four principal examining agencies—the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the executive committee of the National Association of Su-

pervisors of State Banks—have issued a joint statement, which also covers the question of loans to individuals to finance government security purchases on a "borrow-and-buy" basis.

1. There will be no deterrents in examination or supervisory policy to investments by banks in government securities of all types, except those securities made specifically ineligible for bank investment by the terms of their issue.

2. In connection with government financing, individual subscribers relying upon anticipated income may wish to augment their subscriptions by temporary borrowings from banks. Such loans will not be subject to criticism but should be on a short-term or amortization basis fully repayable within periods not exceeding six months.

3. Banks will not be criticized for utilizing their idle funds as far as possible in making such investments and loans and availing themselves of the privilege of temporarily borrowing from or selling Treasury bills to the Federal Reserve banks when necessary to restore their required reserve positions.

This statement makes clear that banks will not be criticized for investing their idle funds as fully as possible in government securities, or for borrowing from the Reserve Banks in connection with such purchases. At the same time it also encourages banks to make temporary loans to individual subscribers to buy government securities, providing such loans are repayable within six months.

Both provisions are in accord with the realities of the times. The old 1-10 ratio was for that matter never a very dependable measure in actual practice, since it took no account of the varying character of risk represented in different banks by holdings of cash, government securities, commercial loans, mortgages, corporate bonds, etc. Mr. Preston A. Delano, Comptroller of the Currency, in a recent address explained that "it is the nature and quality of assets rather than any fixed ratio which determines the adequacy and protection afforded by the capital structure." The present increase in bank assets is entirely in the form of government securities, involving the least possible credit risk, while the policy has been to limit bank subscriptions to maturities of ten years or less.

As for the encouragement of banks to make loans to individual subscribers, the requirement for short-term amortization should serve as a check against the otherwise inflationary effect of such bank credit and provide assurance against the loans being renewed indefinitely. It provides one more inducement for purchases by investors.

Wartime Gold Output and Demand

The decision of the War Production Board in October suspending gold mining in this country for the duration of the war and the report of gold coins being used in some instances by our troops in North Africa have supplied a curiously conflicting mixture of news about gold, and has renewed discussion of the future of that important metal.

The order suspending production has been explained as a purely man-power saving measure, intended to release miners for underground copper and other non-ferrous metal mines, where the shortage of labor is particularly acute. It affects only the strictly gold producing mines, the output of which was already falling because of various wartime restrictions. As the Secretary of the Treasury pointed out, closing the gold mines would not mean any change in the Treasury gold-buying policy or in the prevailing price of \$35 a fine ounce.

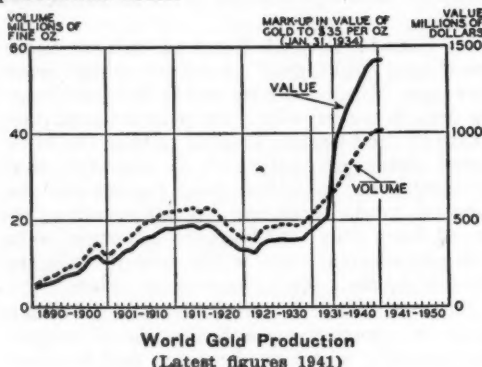
In Canada several hundred miners were transferred from gold to nickel mines some time ago. Mines working solely the gold-bearing ores, however, which contribute about one-fourth of the Dominion's gold output, are to be closed down gradually. It is expected that eventually up to 10,000 gold miners will be released, and, according to information received here, they will have no opportunity to seek employment outside the mining industry but will be assigned to base-metal mines.

The two North American countries are not alone in experiencing a limitation of output. In Australia, where gold mining had been revived as a depression industry, production declined substantially in 1941 and additional labor was shifted during this year to the production of base metals for the new Commonwealth industries.

In Africa, Rhodesian and Gold Coast mines report a rise in production costs, difficulties in obtaining mine equipment, and suspension of new mine development. On the South African Rand—the premier gold-producing area of the world which last year accounted for 35 per cent of total world output—new development has been stopped, but the ore tonnages of existing mines were through September still ahead of last year. Any fear of major interference with gold mining there was dispelled by the Minister of Mines who declared some time ago that the country's war effort was dependent upon gold mining. Only about one in ten of the 400,000 employed in the gold mines can be regarded as skilled workers. Moreover, only a small fraction of the large army of unskilled native labor could be absorbed by the other mines—coal, chrome, manganese, copper, and asbestos—or by the existing industrial enterprises. According to recent data, about one-fifth of the Union of South Africa Government net revenues and about two-fifths of the Union's national income are derived from the gold mining industry.

In other parts of the world—the Philippines, Dutch East Indies, Burma, and New Guinea—war operations must have interfered seriously with production. Diminished flow of mining equipment is creating difficulties for gold producers in Latin America.

As a result of these restrictions, the world output of gold in 1942 probably will show the first decline since 1929. At least until the war is over, the peak year is likely to be 1941, when the world was estimated to have mined some 40.7 million ounces of gold, valued at \$1,425 millions. During the First World War, the production of gold also declined after reaching a temporary peak in 1915, as shown by the accompanying diagram. That decline, however, was brought about primarily by the rise in production costs.



Doubts as to Future of Gold

The spread of popular apprehension as to the future of gold, and doubts as to the workability of the gold standard, have accompanied the deterioration of world economic stability and the gradual breakdown of international relationships since the early 'Thirties. Worldwide suspension of gold redemption of currencies, often referred to inaccurately as "abandoning" gold, sowed first seeds of doubt as to the future of gold. People became accustomed to no longer seeing gold in circulation, and there was a great deal said about the "freedom" allowed by managed currencies as opposed to the "tyranny" of gold. Much was made of the ability of certain countries, notably Germany, to "get along without gold"; of frequent predictions from countries—themselves deficient in gold—of the passing of gold and its monetary functions; and of the abnormal concentration of gold in the United States, which some people saw as a plot on the part of foreign countries to sell us their gold which they would then "declare valueless", leaving us "holding the bag".

More recently the credit arrangements involved in lend-lease have been interpreted by some as further evidence of the diminishing importance of gold. And now comes the closing of the gold mines in this country and in Canada. To quote one commentator, "This is the pro-saic end to something that has been second only to love in the hunger of the human race." "We don't need gold now," he observed, "except for filling teeth."

Gold Still Wanted

Nevertheless, despite such pessimistic pronouncements, a review of wartime experience reveals very good reasons against any premature consigning of gold to the junk heap.

In the first place, the limitation of gold production in this country and in Canada is, as had been said, a purely emergency measure designed to conserve man-power and materials for needs more immediately vital to the war.

Secondly, a decision to reduce gold production temporarily in order to increase capacity for copper, lead, and zinc required for war need no more be considered evidence of lack of regard for gold than a decision to exchange some of the gold in the monetary stock for such materials purchased abroad. This is especially true where the gold holdings are as large as in the United States.

A third, and much more important, reason for disbelieving that gold has "gone out of date" lies in the kind of thing illustrated by the use being made of gold by our forces in North Africa. There it is being demonstrated again that gold is the universal currency, prized above all other, and certain to be accepted where all forms of paper money are under suspicion.

And this is not the only illustration that can be cited. Everywhere that there is opportunity there is manifestation of the age-old instinct of mankind to seek gold as the surest means of preserving wealth, especially in times of uncertainty and disorder. Gold coins, for example, have been selling consistently at heavy premiums ever since the outbreak of the war in all markets where transactions are known to have taken place. The premiums on bar gold have been generally smaller, partly because of rigid restrictions on sale and partly because of high cost of transportation, including maritime and war insurance. For a time in the early months of the war and again in 1940, when Germany was extending its conquest, the Swiss National Bank was reported to have refused to buy gold that large private holders, fearing German invasion, offered for sale. This, however, proved to be temporary, and later the demand for gold in other parts of the world became so insistent and led to such an outflow from Switzerland that the Government last Summer was moved to prohibit exports in order to conserve the monetary stocks.

In India, following the outbreak of war in the Pacific, bar gold rose to about \$40 a fine ounce by the middle of December 1941, and reached almost \$68 an ounce at the time of the Burma campaign in March 1942, with silver up from 50 cents to above 72 cents an ounce. Premiums on gold coin have ranged above bar gold. In neutral countries on the periphery of the Continent of Europe, to which much refugee capital has flown, premiums have likewise

reached high levels. In Lisbon, for example, gold coins command premiums ranging 150 to 200 per cent, while in Turkey, which is now going through an inflationary price rise, gold is selling in a free market at premiums of from 300 to 400 per cent.

From Latin America, too, have come scattered reports of transactions in gold at premium prices, though amounts involved are understood to have been small. In Argentina, which has no restrictions on either the import or export of gold, gold coins were quoted last May on the basis of about \$51 and gold bars at \$42 a fine ounce, with quotations last month at \$47 and \$38 respectively. Ten dollar gold "eagles" were quoted in Havana last April at the equivalent of \$42 a fine ounce, with gold imports free of restrictions but exports subject to 15 per cent tax. Small dealings in United States gold coins have been reported in Panama at a premium of 100 per cent.

The foregoing examples of eagerness on the part of people to get gold—and doubtless there are many more examples that might be cited—would seem to make clear that gold has lost none of its attraction as a secure store of wealth in disturbed times. Economists and governments with an axe to grind may theorize all they like about doing away with gold,—but man's faith in gold persists, and it is precisely this faith which has made gold the best standard of value and monetary base that has yet been devised. Certainly it seems unrealistic to talk about gold not being wanted when people are paying premium prices to get it, and when governments themselves are hoarding it and unwilling to allow free redemption of currencies for fear that the people will come and take too much of it.

In contrast with American gold coins, which command premiums everywhere, it is interesting to record the experience of American paper currency notes now selling abroad at a discount. At the outbreak of war in 1939 such notes, like gold coin, were at a premium in Europe. However, when Great Britain placed an embargo on importation of English notes and forced them to a discount, confidence in American paper notes was likewise affected. As the war went on, this, coupled with the high cost of shipping currency to the United States, forced the notes to a discount, which grew wider on rumors of large scale counterfeiting of American money and finally on our regulations prohibiting importation of our currency from abroad first in amounts in excess of \$250, and now in amounts in excess of \$50. At the present time dollar bills in Lisbon and Switzerland are reported at discounts as high as 50 per cent. Currencies of occupied European countries naturally have slipped faster than the dollar. Francs, for example, quoted officially at 40 per dollar, are selling in "black markets"

as low as 100 francs per paper dollar and 250 francs per gold dollar.

While the discounts quoted on American paper money are no reflection on the intrinsic strength of the United States dollar, they afford further illustration why in time of uncertainty people prefer gold as most likely to afford protection under all conditions.

The Future of Gold in the Monetary System

What has been said above relates primarily, of course, to demand for gold by individuals. But there is no reason to suppose that central banks and governments will give up the use of gold.

In the first place, it is difficult to conceive of a monetary system based upon anything but the precious metals commanding the confidence of the people. Monetary systems cannot be built upon fancy theories, but upon the way people think and behave. Gold and silver have come to be used as money and standards of value not because some group of theorists willed it that way, but because of tradition and practice from time immemorial. And of the two precious metals, gold offers the greater advantage by virtue of its wider use as a base in the past and its greater scarcity.

The Axis conception of a "work unit of value", described at one time by a high Italian official as "representing the productive capacity of a people, which in turn will be a complex of its productive energies and capacities, industrial, agricultural and commercial" seems hardly likely to offer serious competition to gold where people can get gold and desire something more tangible than "units of work", whatever they may be, as the base of their money.

The second reason why gold will be wanted by governments is that it is needed for making international settlements. Without gold for such purposes, the only alternative is strict governmental control of all foreign trade, with continuation of all the paraphernalia of clearings agreements, blocked currencies, trade quotas, and the like, which were stifling international trade up to the war. While clearings agreements may substitute to a limited extent for gold settlements, even Axis propagandists concede that gold cannot be dispensed with entirely but will be useful for international payments.

A third reason why gold will be wanted by governments lies in the huge vested interest in it by the United States and the British Empire—the United States as the world's greatest holder of the metal and the British Empire as the world's greatest producer. Both Powers have every good reason to seek, through example and encouragement, to maintain the place of gold in the world economy, and who can doubt that, with these Powers leading the way, the influence will be far reaching.

Gold a Basis for Confidence

The use of gold in monetary systems does not necessarily mean going back to precisely the same form of gold standard that existed before the war. Discussion of the gold standard tends to be concerned with its mechanics. In reality that is the least important part of the problem. The real question is how the enterpriser can be given assurance about the value of the money he handles, so that he will be prepared to go ahead and employ people and capital.

The goal that is wanted is full employment. But government alone cannot guarantee this. There has to be enterprise. And there cannot be full employment and active private enterprise and trade between nations without removal of some of the uncertainties of recent years. Of course the greatest uncertainty was that of peace or war. Another great uncertainty was whether the money in which business was done might shrink in value in the hands of its holders. There was great reluctance to employ money in other countries to any large extent because of this risk.

A vital question about the future of enterprise is how men can be assured that the money in which they do business will retain its value. Long experience has shown that the promises of governments alone cannot suffice; for these promises have been broken too often. A system of managed currencies, if one means by that term changes in the gold value of currencies, would open the way to international rivalries and suspicions, threatening a new outbreak of competitive currency depreciation—the most devastating form of trade competition.

In the past the free convertibility of currency into gold has been an impartial and non-political guarantee of the value of money. The evidence that has been cited above of demand for gold in many parts of the world is indication of the natural and logical human reaching out for some form of guarantee of the continuity and preservation of values.

No matter what detailed form the monetary mechanism may take in coming years, it is safe to say that unless this basic need for certainty and assurance as to the value of money is satisfied, the goal of full employment will be hard to reach because the human ingenuity and enterprise on which employment rests will be stifled at the source.

The enormous gains in foreign trade and world enterprise and in the standard of living over the whole world of the past century were achieved partly because men had confidence that the pound sterling and the dollar would retain their value. This guarantee took the form of redemption in gold—a language that everyone understood. The forms may change, but this substance is necessary to a revival of world trade and full employment after the war.

The utility of pegging the currency to gold has in fact been demonstrated by this country in recent years. For since January 1934, or for 9 years, the gold value of the dollar has been pegged at the rate of \$35 for an ounce of gold. This Treasury policy has given for these years whatever stability there was in the world monetary system and made the dollar the world's basic currency.

Comparison of U. S. and British Tax Rates

In recent years figures of British taxes and tax rates have been cited often for the purpose of comparing the tax burden in Great Britain and in this country. Interest in such comparisons was stimulated anew by a statement of Secretary of the Treasury Morgenthau who, upon his return early last month from a visit to England, referred in a press interview to British and Canadian taxes, and cited the following Treasury figures showing the British and American income taxes paid by a married person with no dependents:

Income	United States Tax* including income and Victory Tax after post-war credit	Great Britain Income Tax after post-war credit
	Per Cent	Per Cent
\$ 1,000	1.5	5.0
1,200	1.8	8.7
1,500	5.3	12.4
2,000	9.4	18.9
4,000	16.7	30.3
6,000	20.5	34.1
10,000	26.1	42.5
100,000	69.4	83.8

* Includes New York State individual income tax.

Since comparisons of this kind are likely to influence tax policy, it is important that the figures be studied closely from the standpoint of their adequacy as measures of the total tax burden and its distribution. Income taxes, for example, are not the only taxes in this country and in Great Britain. Moreover, there are differences in conception of taxable income, in tax deductions and allowances, and in the purchasing power and living standards represented by equivalent money incomes in American dollars and British pounds. All these factors enter into the question of the comparative tax burden, and unless given consideration tax comparisons will be misleading.

Income Taxes vs. Total Taxes

In the comparison of income rates given in the above table, it will be observed that the figures cited give British rates about twice those of American in the brackets of \$1,500 to \$4,000; in the \$1,000 and \$1,200 classes the ratio is about 4 to 1, while from \$10,000 upward the spread diminishes rapidly in the high brackets, as will be seen from the following table which carries along the table given above:

Income	United States	Great Britain
\$ 200,000	84.6	90.7
300,000	89.1	92.9
400,000	91.4	94.0
500,000	92.8	94.8
1,000,000	95.1	96.1

Perhaps the most widely recognized qualification to the use of income tax rates as measurement of tax burden is the failure to take account of the heavy state and local taxes (including state income taxes) here. In the United States, 34 States and the District of Columbia levy individual income taxes, with rates ranging from 1 to 15 per cent. Thirty-three States levy corporation income taxes with rates ranging from 1 to 8 per cent.

In Great Britain the local taxes are relatively small. The British Government collected 90 per cent of the total tax collections of that country in the fiscal year 1941-42, whereas in the U. S. the Federal Government in 1941-42 collected only 61 per cent. In Canada the Provinces have given up income taxation for the duration of the war.

While the British Government relies to a much greater extent than does our federal government on taxes other than income taxes—largely sales taxes, excise taxes, and customs—this difference is partially offset by our much heavier state and local taxation of real estate, gasoline, retail sales, business franchises, etc.

In a study in the London "Economist" of September 5 an attempt was made to compare total taxes in Great Britain and the United States with total national income produced, after adjusting the statistics of the latter to make them reasonably comparable. In 1938, before the war, the percentage of total taxes to national income in the two countries was according to this study practically the same—20.4 per cent for the U. S. and 21.7 per cent for U. K. With the outbreak of war and the rapid increase in British expenditures and taxation, the ratio rose more rapidly there than here, and in the year 1941 the comparisons were 33.2 per cent for Great Britain against 24.0 per cent for the United States. These ratios, however, do not take account of the rapid rise in taxes which occurred in this country since 1941 and which undoubtedly will bring the ratios closer together again in 1943.

Differences in Living Standards

Perhaps an even more basic qualification to such comparisons, which is not so well understood, is the fact that the comparisons are of two different countries, of different moneys and different standards in living costs.

Prior to the war, the general level of incomes and living costs in England was much below that of the United States, and while the war has brought an increase in money incomes and cost of living in both countries, wide disparities continue to exist. Prior to war restrictions a typical British family enjoyed a con-

siderably better scale of living than would have been possible on the same money income in this country. A Britisher who was regarded as having a "comfortable income" would be classed as "poor" in many parts of the United States, while a "good income" in Britain would be called only "moderate" here, and so on.

The much greater proportion of English families in the low income groups may be seen by comparing the distribution of British taxpayers by income classes in the fiscal year 1941-42, as taken from British Treasury statistics by the London "Economist", with the distribution of United States families and single consumers in the calendar year 1941, as estimated by the O.P.A. In Great Britain the estimated number of families and individuals with incomes of \$500 to \$1,000 comprised approximately 67 per cent of the total, while the two groups from \$500 to \$2,000 comprised 93 per cent. In the United States the corresponding proportions were 23 per cent and 64 per cent, respectively. Whereas in the United States the number of family and individual taxpayers having incomes over \$10,000 comprised 2 per cent of the total, in Great Britain the number of taxpayers having incomes of over \$12,000 comprised only 0.6 per cent of the total.

Similar evidence as to the lower scale of incomes in Great Britain may be obtained by comparing the average weekly earnings in the 16 major industries covered by the Ministry of Labor statistics with the average for 27 major manufacturing industries in the United States as compiled by the National Industrial Conference Board. This indicates that the average British industrial workman receives, for a 52-hour working week, an annual rate of around \$1,060, upon which his income tax would be about 5 per cent, according to the figures cited by Secretary Morgenthau, whereas the average American factory worker, for a 43-hour working week, receives about \$2,060 per year, on which his income tax under the new rates would be about 9 per cent.

A British Ministry of Labor study showed for 1937-38 an average expenditure of 85 shillings per week by industrial households, equal to \$1,075 annually. Figures for the United States for a comparable income group for the same period showed an annual expenditure of about \$1,800. For food, the American worker's family spent about \$570, while the British worker's family in about the same circumstances spent about \$430. It is generally recognized that ordinary clothing, particularly woollens, is much cheaper in England. Reflecting lower wage levels, practically all types of professional, household and other services are generally cheaper.

On the whole, the evidence seems to indicate that under normal conditions an English wage of 50 to 60 per cent of the American wage

would yield the accepted standard of living for both countries. To the extent that this is still true, an American income of say \$4,000 per year taxed at 17 per cent will be less comparable with a British income of \$4,000 taxed at 30 per cent than with a British income of \$3,000 taxed at 26 per cent, or perhaps even as low as \$2,000 taxed at 19 per cent. To be sure, the steep increase in the price of all non-controlled goods and services in Britain and the heavy purchase tax (as high as 66 per cent on luxuries) take away part of the British advantage prevalent in peacetime. Another factor in assessing the relative burden of taxation is that a large area of the normal field of expenditures is restricted in Great Britain through goods and services not being available. These restrictions upon consumption undoubtedly have aided the British in carrying their unprecedented tax burden.

The difference in income standards and living costs in the two countries is reflected in the fact that the number of persons in Great Britain having large incomes by American standards is smaller than in this country. The comparisons often cited of the number of persons having incomes over \$25,000 *after* taxes are not in itself proof that taxation of the upper incomes is heavier there than here, for the number of persons having incomes over \$25,000 *before* taxes is likewise much smaller in Great Britain than in this country.

Differences in Conception of Taxable Income

Besides these broad considerations, there are many specific differences in the two tax systems which make comparison difficult. One of these differences has to do with treatment of corporations and of corporate dividends.

British corporations are subject to an excess profits tax of 100 per cent on the net income above the "standard year" or best average of certain selected years, with 20 per cent of such tax subject to refund after the war. American corporations are subject to an excess profits tax of 90 per cent, with a post-war refund of 10 per cent, and with an over-all tax ceiling of 80 per cent. On the balance after excess profits tax, the British corporation pays the normal income tax of 50 per cent, while the American corporation pays the combined normal and surtax of 40 per cent on the income not subject to excess profits tax.

When the corporate net income is passed on as dividends, however, it is not subject in England to further normal income tax in the hands of the individual, as would be the case in this country. The British surtax does not apply to individuals with incomes of less than \$8,000, though above that level dividend income is subject to surtax computed at double the regular rates. If the income of the individual shareholder is less than his exemptions, the British allow him a refund of the tax paid by the cor-

poration. Under our system of taxation we allow the individual no credit for the tax paid by the corporation.

The effect of these provisions is to give the British recipient in the low and medium brackets a decided advantage over the American. In the brackets of \$100,000 upwards, an American shareholder of a corporation already paying excess profits taxes finds that the corporate and individual income taxes together take 99 per cent or more of any *increase* in corporate earnings, or practically the same as the British tax, which would take 100 per cent of such increase.

In Canada, as in this country, no credit is allowed the individual shareholder for income taxes paid by the corporation. However, where the corporation pays excess profits taxes (100 per cent, with 20 per cent post-war refund like the British) the corporation pays only 30 per cent, instead of the regular 40 per cent Canadian normal tax. The fact that the shareholder receives no credit for income taxes paid by the corporation was mentioned by the Canadian Finance Minister in his budget message last Spring as one of the main reasons for not proposing a further increase in the corporate normal tax above 40 per cent.

Another important difference in the two tax systems is that the American revenue acts for year have included capital gains in taxable income, and included capital losses (to a limited extent) in allowable deductions, whereas the British do not.

The British income tax is more liberal than ours in that it permits a deduction for life insurance premiums paid (up to one-sixth of income), and also permits deduction of an employee's contribution to pension funds.

On the other hand, U. S. taxpayers may deduct charitable contributions up to 15 per cent of their net incomes. Britain permits such deductions in only very limited instances.

Among other differences in the definition of taxable income under the two tax systems is the requirement in England that joint returns be filed by husband and wife, whereas in this country, where women traditionally have had a more independent status, separate returns are optional.

In England the owner of a home which he occupies is required to pay a tax on the imputed rental value of such home. Thus an Englishman who could rent his home for \$1,000 a year would be taxed on that amount.

Interest on U. S. state and local government securities, as well as on certain outstanding federal issues, is wholly or partially exempt from tax. Britain taxes all interest.

An earned income credit against normal tax (but not against surtax) of 10 per cent is permitted by each country. But the U. S. credit stops at an income of \$14,000 and the British credit stops at \$6,000.

Personal exemptions in the U. S. under the new law and in England are, for single persons, \$500 and \$320, respectively, and for married couples \$1,200 and \$560. In the U. S. the 5 per cent Victory Tax applies to gross incomes of everyone in excess of \$624 a year.

American taxpayers are allowed a credit of \$350 for each child, while British couples get only \$200. American families can keep the credit until their children reach the age of 18, but the credit stops in England at 16.

U. S. taxpayers also can claim the same credit for wholly dependent relatives, but Britain allows only \$100 for such dependents. However, the British permit an exemption of \$200 for a housekeeper for a widow or widower, and grant a 10 per cent old-age allowance, starting at age 65, on incomes up to \$2,000.

Task of Balancing Differences

This condensed summary of many, though by no means all significant differences in the American and British tax systems illustrates the difficulty of weighing the relative severity of the two systems.

First and foremost is the difficulty of reconciling the difference in income standards and living costs in the two countries. Studies of tax differences cannot be based merely upon equivalent money incomes without taking these factors into consideration. So far as the relative standard of living is concerned, a pound of income in Great Britain probably is more nearly comparable with \$6 to \$8 in this country than with \$4. This comparison holds more or less true through the income scale, and if tax comparison is made on this basis it yields a different result. It indicates a much nearer equality in income tax burden than appears from the rates alone. This is particularly true in the upper brackets where the rates themselves tend towards equality.

Secondly, there is the difficulty of reconciling the different forms of taxation and conception of taxable income in the two countries. In some respects—notably in the absence of heavy local taxation, in the exemption of capital gains, and in the treatment of corporate dividends, life insurance premiums and pension contributions—the British tax system is less severe than ours. In various other respects—notably in the high income rates in the low brackets, in mandatory joint returns, in the disallowance of most contributions, and in the absence of tax exempt securities—the British system is more severe than ours.

Yet the task of balancing such differences, one against the other, is one of great complexity, rendered more difficult by the fact that the different tax provisions affect different

people differently. An American married couple, for example, may pay more taxes under our system permitting separate tax returns and allowances for contributions than they would pay under the British system if part of their income is from capital gains or if they are subject to heavy local taxes; while with another couple differently situated the result might be entirely different. The tax exemption for municipal bonds which our system provides is no advantage to the average American business man with most of his funds invested in his own or other active enterprises. And such examples could be multiplied again and again.

All this only goes to emphasize again the formidable nature of the problem of comparison. Nevertheless, certain broad generalizations seem warranted:

1. That when all types of taxes are taken into account the over-all tax burden in this country at the new federal rates does not appear to be as much less than the burden in Great Britain as a comparison of income tax rates alone would imply.

2. That the difference in income tax rates decreases rapidly in the upper brackets, and in some cases, such as dividends and capital gains, the rates here may be higher.

3. That the British tax system is more broadly based than ours, in that it reaches down further into the lower brackets and relies more upon indirect taxes, including sales taxes.

And, finally, it might be pointed out that just because Great Britain or Canada do certain things does not necessarily prove that these are the wisest things to do. For example, the high British and Canadian excess profits taxes (100 per cent with 20 per cent post-war rebate) have been criticized in both countries as discouraging to efficiency and economical production. In Great Britain, the provision for mandatory joint returns has been asserted to be a serious deterrent to entry of women into full-time employment and hence a retarding influence upon maximum war production. While it is desirable that the tax laws of other countries be studied for ideas and suggestions and with a view to our profiting by the experience of others, the final determination of taxes must be made not on the basis of what some other country does, but upon the known conditions here and the need for adapting our tax system to the American environment and the effective prosecution of the war effort.

The real test in both countries is whether the tax system can be tightened further without injuring the war effort and whether it deals adequately with the problem of inflation.

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